

**Council Meeting: March 5, 2013****SUBJECT: Consideration of Council Policy Ensuring Future Funding of City Infrastructure****BACKGROUND**

The City's infrastructure, including its administrative facilities such as City Hall and the Corporation Yard, is aging and in need of rehabilitation, renovation, and/or replacement. At this point in time, however, sufficient funds have not been set aside to fund all of the required work. This is the result of a number of factors, including the uncertainty of the plans for the renovation/replacement of City Hall and the diversion of funds set aside for infrastructure renovation to address budgetary issues.

The FY 2011/12 Adopted Budget began to address the funding shortfall by setting aside a total of \$28 million over the 20-year plan to fund accelerated rehabilitation work on the City's streets. The FY 2012/13 Adopted Budget continued to address infrastructure funding by setting aside another \$1.5 million annually, a total of \$30 million over 20 years, for infrastructure rehabilitation. These funds are not yet earmarked for specific projects but are set to accumulate in the Infrastructure Fund for future appropriation.

Given the City's recent commitment to replenishing funding for infrastructure work, as well as the specific request from Councilmembers Moylan and Griffith to bring forth for consideration a formal policy related to infrastructure funding (August 28, 2012 Council meeting), the purpose of this report is to identify for Council the options it has with respect to maintaining funding for infrastructure renovation that has been programmed into the long-term financial plan.

EXISTING POLICY

Council has adopted a number of policies that provide direction and goals related to infrastructure funding. These policies, referenced below, include prioritizing the maintenance of existing facilities over the provision of new facilities and articulating the ideal funding strategy for governmental assets. And while current Council policy does not explicitly require funding to be set aside for the purpose of infrastructure renovation or replacement, the existing policies provide a framework for planning for infrastructure renovation and replacement while maintaining the flexibility for Council to be able to adjust to changing economic conditions.

Council Fiscal Policy 7.1C.1.3 – High priority should be given to replacing capital improvements prior to the time that they have deteriorated to the point where they

are hazardous, incur high maintenance costs, negatively affect property values, or no longer serve their intended purposes.

Council Fiscal Policy 7.1C.1.5 – Priority will be given to the repair and replacement of existing infrastructure as compared to the provision of new or expanded facilities.

Council Fiscal Policy 7.1C.1.9 – Capital improvements should be maintained to the level required to adequately protect the City’s capital investment and to minimize future maintenance and replacement costs.

Council Fiscal Policy 7.1C.1.11 – The Infrastructure Renovation and Replacement Fund shall be used to account for projects related to the City’s Long-Range Infrastructure Plan for the renovation and replacement of existing general City assets. Infrastructure projects related to the City’s utilities shall be accounted for in the respective utility fund.

Council Fiscal Policy 7.1C.2.1 – Governmental capital improvements should be funded on a “pay-as-you-go” basis in most cases. Alternate financing strategies may be considered in light of the specific project and the consequences of each financing strategy.

Council Fiscal Policy 7.1I.1b.7 – Resources for the capital requirements of each utility such as bond proceeds or connection fees should be dedicated only for capital projects and not be used for ongoing maintenance and operations.

Council Fiscal Policy 7.1I.1b.8 – The annual depreciation expense of the assets of each utility should be set aside into a Rehabilitation and Replacement Reserve as a minimum funding level for system replacement.

DISCUSSION

The City’s current inventory of infrastructure, particularly its administrative facilities, was built predominantly in the 1960s. Given the age and condition of these facilities, as well as the space needs of the City’s current workforce, significant rehabilitation, renovation, and/or replacement is necessary. In fact, this work has been needed for a number of years, and the City has taken some steps over the past 15 years to lay the groundwork for renovated or new City facilities.

In FY 1996/97, the Infrastructure Fund was established for the purpose of accumulating funding for the City’s infrastructure needs. This was done in conjunction with the development of the Long-Range Infrastructure Plan (LRIP), which was a comprehensive study of the future renovation and replacement needs of City infrastructure. Phase I of the LRIP, which covered the renovation or replacement of existing non-utility assets, was completed in 1997, and based on the results, the FY 1998/99 long-term financial plan for the General Fund included approximately \$74 million in transfers from the General Fund to the Infrastructure Fund over 20 years to provide funding for execution of Phase I of the LRIP. These transfers from the General Fund to the Infrastructure Fund were to serve two purposes: funding current

projects for existing infrastructure and setting aside funding for the large-scale projects identified in the LRIP.

Between FY 1998/99 and FY 2006/07, the General Fund contributed a total of \$17.6 million to the Infrastructure Fund. This funded a number of projects, including rehabilitation work at the Civic Center, Corp Yard, and various park buildings, as well as contributed to the accumulation of a \$13.4 million reserve in the Infrastructure Fund. FY 2006/07 was the last year that set-aside contributions were made to the Infrastructure Fund from the General Fund, as the \$1.7 million transferred between FY 2007/08 and FY 2010/11 was to cover project costs only, not contributions for future infrastructure work. It is important to note that a portion of the set-aside contribution from the General Fund that was eliminated was supplanted by Park Dedication, Gas Tax, and other street-specific revenue sources for those projects, leaving the contribution gap primarily tied to administrative infrastructure. At the end of FY 2010/11, the Infrastructure Fund had a reserve of \$10.3 million, with almost all of that amount earmarked for existing, planned projects as opposed to set aside for large-scale rehabilitation or renovation. Recognizing the need to re-establish planned funding for infrastructure, including setting aside funding for large-scale projects such as the renovation or replacement of the Civic Center, the City began to take action to replenish funding for major infrastructure work in FY 2011/12. This included programming \$28 million over the 20-year plan for accelerated street rehabilitation and maintenance. In FY 2012/13, the City programmed another \$30 million over the 20-year plan for yet-to-be-determined projects.

Going forward, it is important that the City maintain the funding it is currently planning to set aside for necessary infrastructure work, and there are several ways this can be accomplished. Options include creating a Council policy or passing an ordinance requiring the set aside of funding for future infrastructure needs and restricting the use of those funds. It is important to note, however, that neither amending Council policy nor passing an ordinance to restrict funds set aside for infrastructure would be effective in and of themselves in preventing future Councils from utilizing the funds for another purpose. Future Councils could amend Council policies, repeal ordinances, or simply not follow policies in order to be able to utilize the funds in another manner. Additionally, adherence to any Council policy on infrastructure renovation would have to be considered within the context of all Council policies and priorities, especially in difficult economic times when revenue shortfalls and/or unplanned expenditure increases require all aspects of the City's budget to be analyzed and prioritized.

For example, when the recession began in 2008 and the General Fund's structural deficit had to be addressed over the next several years through the annual budget process, all avenues for expenditure reductions were considered. This included evaluating personnel actions such as furloughs and layoffs, employee compensation concessions, service-level reductions, organizational restructuring for better operational efficiency, reductions to infrastructure funding (including streets, trees, and sidewalks funding), and drawdowns of the Budget Stabilization Fund. During

this evaluation process, Council indicated that layoffs should only be utilized as a last resort. As such, the structural deficit had to be addressed using the other options discussed above, including reducing planned funding for infrastructure despite existing Council policy on infrastructure maintenance and renovation. Flexibility to evaluate as many options as possible allows for Council to set priorities specific to that circumstance.

Furthermore, while maintaining set-aside funding is important, there are compelling reasons as to why a specific policy or ordinance restricting the use of infrastructure set-aside funds could have unintended consequences. As an example, rating agencies look favorably on flexible funds, so restricting funds that could be utilized for any purpose could potentially have an impact on the City's issuer credit rating or ratings on specific future bond issues.

Another option, which balances the need to set aside funding for future infrastructure while also providing Council with flexibility to utilize available funds for other purposes as conditions change, is to maintain planned set-aside funding for infrastructure and appropriate those funds for specific projects as they are identified and prioritized. One of the factors that contributed to the planned General Fund transfers to the Infrastructure Fund being diverted for other uses was there was no specific plan to spend the money, and as such, the funds were not appropriated to specific projects. Developing a plan, establishing projects, and appropriating funding will help ensure funds earmarked for infrastructure are not diverted while also leaving Council the flexibility to utilize funds set aside but not yet appropriated for other purposes, if necessary. This approach is currently being utilized for the set-aside funds established in the FY 2011/12 and FY 2012/13 Adopted Budgets. The \$28 million in additional infrastructure funding programmed into the FY 2011/12 Adopted Budget has been appropriated to a specific project for accelerated street repairs, so these funds are not available to divert unless the street rehabilitation and repair project is defunded. The \$30 million in additional funding programmed into the FY 2012/13 Adopted Budget, however, does not yet have a specific purpose identified and could be utilized for another purpose if Council chose to do so. With that said, should Council want to ensure this \$30 million is utilized for infrastructure, particularly the renovation of the Civic Center campus, the best course of action is to move forward with a specific plan that utilizes the current set-aside funding and appropriates it to specific projects.

FISCAL IMPACT

There is no fiscal impact related to Council consideration of developing a policy to ensure funding is available in the future to rehabilitate and/or replace City infrastructure.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website.

RECOMMENDATION

Staff recommends not establishing any additional policies regarding funding for infrastructure. There are seven existing policies relating to infrastructure funding that provide the framework for the overall prioritization of this funding, and as such, staff believes an additional policy restricting the use of general purpose funds for infrastructure is not only unnecessary, but could also lead to unintended negative consequences such as a downgrade of the City's credit rating.

Staff believes the most effective way to ensure funding set aside for infrastructure actually gets used for that purpose is for infrastructure needs to be identified and prioritized, with projects established and funded based on those priorities. This has been an effective mechanism for the funds that were set aside in the FY 2011/12 Adopted Budget, as street rehabilitation was prioritized as the most pressing infrastructure need, and the set aside funds were incorporated into the budget on a multi-year basis and subsequently appropriated into a street rehabilitation project that is currently underway. In addition, Council recently authorized the proceeds from the future sale of the Raynor Activity Center be used to construct the Lakewood Branch Library, which is another example of the effectiveness of identifying priority needs and funding projects to address those needs. With an additional \$30 million programmed over the 20-year planning period incorporated into the FY 2012/13 Adopted Budget, staff believes the best course of action to ensure these funds are utilized for infrastructure is to advance the discussion and analysis on the future renewal of the Civic Center complex. The resulting project(s) would be prioritized and funds appropriated as necessary to complete the effort.

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